SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Cedillo, et al. Analyst: Jeani Brent Bill Number: AB 601

Related Bills: See Prior Analysis Telephone: 845-3410 Amended Date: 07/13/1999

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Urban Adaptive Reuse Zones/Qualified Adaptive Reuse Buildings Credit/ Department to Report to Legislature Regarding Credit

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

__X__ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended June 24, 1999 .

__X__ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO _____.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 19, 1999, AND AMENDED April 19, 1999, and June 24, 1999, STILL APPLY.

____ OTHER - See comments below.

SUMMARY OF BILL

Under the Government Code, this bill would authorize a new type of economic development area, called urban adaptive reuse zones (UARZ). The Trade and Commerce Agency (TCA) would be required to designate up to 10 UARZs from applications submitted by local governing bodies. The designations would be binding for ten years with the possibility of a five-year extension if specified vacancy rates exist at the end of the ten-year initial designation period.

Local legislative bodies may by ordinance designate buildings located within a UARZ as "qualified adaptive reuse buildings." To be designated, buildings must have been built before 1975 and have been 50% or more vacant, excluding first floor retail space, for a period of six months or longer, within the 12 months prior to the application for designation. The ordinance would require property owners to enter into "adaptive reuse restriction" agreements to continue to use the property for adaptive reuse housing for a period of ten years. Qualified adaptive reuse buildings would be eligible for various regulatory, tax, program, and other incentives, and TCA would be required to adopt regulations concerning the application and designation process.

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill, by conforming with modifications to the federal rehabilitation credit, would allow a state credit equal to either of the following:

1. 20% of the amount paid or incurred during the taxable or income year in connection with the rehabilitation of a qualified adaptive reuse building, or

2. 30% of the amount paid or incurred during the taxable or income year in connection with the rehabilitation of a qualified adaptive reuse building that

Board Position:			Legislative Director	Date
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meets the federal minimum income housing set-aside requirements or is listed in the California Register of Historical Resources.

This bill would make various changes to other provisions of the Government Code and the Revenue and Taxation Code. These changes do not impact the department's programs or procedures and are not discussed in this analysis.

SUMMARY OF AMENDMENT

The July 13, 1999, amendments would disallow the credit for any taxable year in which the taxpayer violates the "adaptive reuse restriction" agreement and would require the taxpayer to recapture any credit previously claimed. The amendments also would require the department annually to report to the Legislature the number and amount of credits claimed and utilized.

The July 13, 1999, amendments did not resolve the implementation considerations addressed in the department's analysis of the bill as amended June 24, 1999, which are included below. Also, the July 13, 1999, amendments raise an additional implementation consideration (#5 below) and a technical consideration. Except for the items discussed in this analysis, the department's analyses of the bill as introduced February 19, 1999, and as amended April 19, 1999, and June 24, 1999, still apply.

IMPLEMENTATION CONSIDERATIONS

This bill raises the following implementation considerations:

1. This bill uses the phrase "minimum housing set aside requirements" as contained in Section 42(g) of the Internal Revenue Code. However, Internal Revenue Code Section 42(g) does not contain that phrase. The proposed amendments would change the phrase to "qualified low-income housing project requirements," as contained in Section 42(g)(1).

2. The attached proposed amendments would make stylistic changes to the PITL and B&CTL provisions to ensure consistency with other federal conformity language used throughout the PITL and B&CTL.

3. This bill does not provide a sunset date. However, if the bill were amended to provide a sunset date, consideration should be given to limiting the number of years the unused portion of any credit could be carried forward. Credits with unlimited carryovers must be maintained on tax forms and systems even long after the underlying credit has expired. Since tax credit carryovers are usually exhausted within eight years, most recently enacted credits contain limited carryover provisions.

4. This bill states that no credit would be allowed for any taxable or income year in which the taxpayer violates the adaptive reuse restriction agreement. Because the department would not administer the agreement, it would be difficult for the department to determine whether the agreement had been violated. The proposed amendments would provide that the government official designated in the local ordinance, provided in the Government Code, would determine whether a violation has occurred and would notify the department of each violation.

5. In addition, after discussions with the author's staff and Trade and Commerce Agency staff, the department understands that the Government Code provisions of the bill will be amended to provide for dedesignation of urban adaptive reuse zones where the local government fails to fulfill its obligations as specified in the bill. Pursuant to the request of the author's staff, the attached amendments would provide that taxpayers not be denied the credit in the case of dedesignation of the zone as long as the taxpayer otherwise would be allowed the credit.

TECHNICAL CONSIDERATIONS

The proposed amendments would correct a grammatical error contained in the provision that would require the department to report to the Legislature and would rephrase this provision to clarify that the report is to include credits and credit carryover claimed.

LEGISLATIVELY MANDATED REPORTS

This bill would require the department to report annually to the Legislature the number and amount of credits and credit carryover claimed each year.

TAX REVENUE ESTIMATE

Revenue losses under the PITL and B&CTL are estimated as follows:

Effective for Income/Taxable Years Beginning January 1, 2000 (in millions)		
1999-0	2000-1	2001-2
$-10	$-60	$-65

Approximately 20% of the impact above is attributed to the PITL.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

REVENUE ESTIMATE DISCUSSION

Revenue losses under the PITL and B&CTL would depend on the amount of qualified expenditures each year and the ability of taxpayers to apply calculated credits against available state income tax liabilities (including any alternative minimum tax limitations).

The above estimates are based on federal revenue loss projections for the federal rehabilitation credit, prorated to California and allowing for the modifications provided in this bill.

BOARD POSITION

Neutral.

At its July 6, 1999, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on this bill as amended June 24, 1999.

Analyst Jeani Brent
Telephone # 845-3410
Attorney Patrick Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 601
As Amended July 13, 1999

AMENDMENT 1

On page 10, strikeout lines 25 through 40, strikeout pages 11 through 13, and insert:

17053.76. For each taxable year beginning on or after January 1, 2000, there shall be allowed as a credit against the "net tax," as defined in Section 17039, an amount determined in accordance with Section 47 of the Internal Revenue Code, modified as follows:

(a) Sections 47(a)(1) and 47(a)(2) of the Internal Revenue Code do not apply and in lieu thereof the following provisions shall apply:

(1) 20 percent of the amount paid or incurred during the taxable year in connection with the rehabilitation of a qualified adaptive reuse building (other than a building described in paragraph (2)), and

(2) 30 percent of the amount paid or incurred during the taxable year in connection with the rehabilitation of a qualified adaptive reuse building that is either of the following:

(A) a structure that meets the "qualified low-income housing project" requirements as described in Section 42(g)(1) of the Internal Revenue Code, or

(B) a structure listed in the California Register of Historical Resources.

(b) For purposes of this section, Section 47(c)(1)(A) of the Internal Revenue Code shall be applied by substituting "qualified adaptive reuse building" for "qualified rehabilitated building" except where otherwise provided. "Qualified adaptive reuse building" means a building described in Section 7093 of the Government Code.

(c) The references to the year "1936" in Section 47(c)(1)(B) of the Internal Revenue Code are modified to refer to the year "1975."

(d) Section 47(c)(1)(C)(i)(I) of the Internal Revenue Code, relating to the definition of "substantially rehabilitated," is modified to provide that the "qualified rehabilitation expenditures" must exceed 10 percent of the adjusted basis in the qualified adaptive reuse building.

(e) Section 47(c)(2)(C) of the Internal Revenue Code, relating to the definition of "certified rehabilitation," is modified to mean any rehabilitation of a qualified adaptive reuse building that is a certified historic structure that the State Historic Preservation Officer has certified as conforming with the Secretary of the Interior's Standards for Rehabilitation.

(f) Section 47(c)(3) of the Internal Revenue Code, relating to "certified historic structure defined," does not apply and in lieu thereof, a "certified historic structure" means a structure listed in the California Register of Historical Resources.

(g)(1) In the case where any taxpayer who is a property owner is found by the local government official designated in the local ordinance specified in

Section 7093 of the Government Code to have violated the adaptive reuse restriction agreement at any time during the applicable term, both of the following shall apply:

(A) No credit shall be allowed during the taxable year in which the violation occurs.

(B) The amount of the credit previously claimed, with respect to the qualified adaptive reuse building, shall be added to the taxpayer's tax liability in the taxable year of the violation.

(2) The local government designated in the local ordinance specified in Section 7093 of the Government Code shall notify the department of each adaptive reuse restriction violation. The notification shall include each of the following:

(A) The taxpayer's name.

(B) The taxpayer's identification number, and each partner's taxpayer identification number in the case of a partnership, for tax administration purposes.

(C) The date on which the violation was found to have occurred.

(3) For purposes of this subdivision:

(A) "Adaptive reuse restriction agreement" means an agreement described in subdivision (b) of Section 7093 of the Government Code.

(B) "Applicable term" means the term of the agreement described in subdivision (b) of Section 7093 of the Government Code.

(C) "Property owner" means the property owner discussed in subdivision (b) of Section 7093 of the Government Code.

(h) No tax credit shall be denied in the case where the urban adaptive reuse zone, described in Section 7092 of the Government Code, in which the qualified adaptive reuse building is located is dedesignated by the Trade and Commerce Agency pursuant to Section _____ of the Government Code, and the credit otherwise would be allowed by this section.

(i) In the case where the credit allowed by this section exceeds the "net tax," the excess may be carried over to reduce the "net tax" in the following year, and succeeding years if necessary, until the credit is exhausted.

(j) The Franchise Tax Board shall report annually to the Legislature the number and amount of credits and credit carryover claimed under this section.

SEC. 6. Section 23608.4 is added to the Revenue and Taxation Code, to read:

23608.4. For each income year beginning on or after January 1, 2000, there shall be allowed as a credit against the "tax," as defined in Section 23036, an amount determined in accordance with Section 47 of the Internal Revenue Code, modified as follows:

(a) Sections 47(a)(1) and 47(a)(2) of the Internal Revenue Code do not apply and in lieu thereof the following provisions shall apply:

(1) 20 percent of the amount paid or incurred during the income year in connection with the rehabilitation of a qualified adaptive reuse building (other than a building described in paragraph (2)), and

(2) 30 percent of the amount paid or incurred during the income year in connection with the rehabilitation of a qualified adaptive reuse building that is either of the following:

(A) a structure that meets the "qualified low-income housing project" requirements as described in Section 42(g)(1) of the Internal Revenue Code, or

(B) a structure listed in the California Register of Historical Resources.

(b) For purposes of this section, Section 47(c)(1)(A) of the Internal Revenue Code shall be applied by substituting "qualified adaptive reuse building" for "qualified rehabilitated building" except where otherwise provided. "Qualified adaptive reuse building" means a building described in Section 7093 of the Government Code.

(c) The references to the year "1936" in Section 47(c)(1)(B) of the Internal Revenue Code are modified to refer to the year "1975."

(d) Section 47(c)(1)(C)(i)(I) of the Internal Revenue Code, relating to the definition of "substantially rehabilitated," is modified to provide that the "qualified rehabilitation expenditures" must exceed 10 percent of the adjusted basis in the qualified adaptive reuse building.

(e) Section 47(c)(2)(C) of the Internal Revenue Code, relating to the definition of "certified rehabilitation," is modified to mean any rehabilitation of a qualified adaptive reuse building that is a certified historic structure that the State Historic Preservation Officer has certified as conforming with the Secretary of the Interior's Standards for Rehabilitation.

(f) Section 47(c)(3) of the Internal Revenue Code, relating to "certified historic structure defined," does not apply and in lieu thereof, a "certified historic structure" means a structure listed in the California Register of Historical Resources.

(g)(1) In the case where the taxpayer who is a property owner is found by the local government official designated in the local ordinance specified in Section 7093 of the Government Code to have violated the adaptive reuse restriction agreement at any time during the applicable term, both of the following shall apply:

(A) No credit shall be allowed during the taxable year in which the violation occurs.

(B) The amount of the credit previously claimed, with respect to the qualified adaptive reuse building, shall be added to the taxpayer's tax liability in the taxable year of the violation.

(2) The local government designated in the local ordinance specified in Section 7093 of the Government Code shall notify the department of each adaptive reuse restriction violation. The notification shall include each of the following:

(A) The taxpayer's name.

(B) The taxpayer's identification number, and each partner's taxpayer identification number in the case of a partnership, for tax administration purposes.

(C) The date on which the violation was found to have occurred.

(3) For purposes of this subdivision:

(A) "Adaptive reuse restriction agreement" means an agreement described in subdivision (b) of Section 7093 of the Government Code.

(B) "Applicable term" means the term of the agreement described in subdivision (b) of Section 7093 of the Government Code.

(C) "Property owner" means the property owner discussed in subdivision (b) of Section 7093 of the Government Code.

(h) No tax credit shall be denied in the case where the urban adaptive reuse zone, described in Section 7092 of the Government Code, in which the qualified adaptive reuse building is located is dedesignated by the Trade and Commerce

Agency pursuant to Section _____ of the Government Code, and the credit otherwise would be allowed by this section.

(i) In the case where the credit allowed by this section exceeds the "tax," the excess may be carried over to reduce the "tax" in the following year, and succeeding years if necessary, until the credit is exhausted.

(j) The Franchise Tax Board shall report annually to the Legislature the number and amount of credits and credit carryover claimed under this section.